

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman; and
Robert G. Taub

Periodic Reporting
(Proposals One Through Five)

Docket No. RM2013-6

ORDER ON ANALYTICAL PRINCIPLES USED IN
PERIODIC REPORTING
(PROPOSALS ONE THROUGH FIVE)

(Issued February 4, 2014)

I. INTRODUCTION

In Order No. 203, the Commission adopted periodic reporting rules pursuant to 39 U.S.C. § 3652.¹ Those rules require the Postal Service to obtain advance approval, in a notice and comment proceeding under 5 U.S.C. § 553, whenever it seeks to change the analytical principles that it applies in preparing its periodic reports to the Commission required by section 3652.

On August 16, 2013, the Postal Service filed a petition pursuant to 39 C.F.R. § 3050.11 requesting that the Commission initiate an informal rulemaking proceeding to consider four proposals to change the analytical methods approved for use in periodic

¹ Docket No. RM2008-4, Notice of Final Rule Prescribing Form and Content of Periodic Reports, April 16, 2009 (Order No. 203).

reporting.² In its Petition, the Postal Service also seeks clarification concerning the status of a proposal previously filed by the Postal Service as part of its June 26, 2013 response to a Commission request for additional information arising from the 2012 Annual Compliance Determination (ACD) report.³

On August 20, 2013, the Commission issued Order No. 1814 initiating this rulemaking proceeding; providing for the submission of comments and reply comments; and appointing a Public Representative.⁴ In addition, Order No. 1814 treated the Postal Service's request for clarification as a petition pursuant to 39 C.F.R. § 3050.11, and labeled the Revised Response No. 3 to the FY 2012 ACD report as Proposal Five to be reviewed in this docket.⁵ The Public Representative filed comments in response to Order No. 1814.⁶ The Postal Service filed reply comments on September 23, 2013.⁷ The Postal Service also responded to Chairman's Information Request (CHIR) Nos. 1 and 2.⁸

² Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals One Through Four), August 16, 2013 (Petition).

³ *Id.* at 1; see Docket No. ACR2012, Annual Compliance Determination Report, Fiscal Year 2012, March 28, 2013 (FY 2012 ACR), at 169-70; see also Docket No. ACR2012, Responses of the United States Postal Service to Commission Requests for Additional Information in FY 2012 Annual Compliance Determination, June 26, 2013 (Response No. 3); and Docket No. ACR2012, Revised Responses of the United States Postal Service to Commission Requests for Additional Information in FY 2012 Annual Compliance Determination, July 31, 2013 (Revised Response No. 3).

⁴ Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposals One Through Five), August 20, 2013 (Order No. 1814).

⁵ *Id.* at 2. Revised Response No. 3 and the accompanying Excel file Attachment 1.xls, a non-public filing included in Library Reference USPS-FY-12-NP42, are hereby incorporated by reference in this docket. Note 3, *supra*.

⁶ Public Representative Comments in Response to Order No. 1814 Concerning Rulemaking on Analytical Principles Used in Periodic Reporting (Proposals One Through Five), September 9, 2013 (PR Comments).

⁷ See Reply Comments of the United States Postal Service, September 23, 2013 (Reply Comments); Motion for Late Acceptance of Reply Comments, September 23, 2013 (Motion). The Postal Service's Motion is hereby granted.

⁸ Responses of the United States Postal Service to Questions 1-9 of Chairman's Information Request No. 1, September 16, 2013 (Response to CHIR No. 1); Responses of the United States Postal Service to Questions 1-2 of Chairman's Information Request No. 2, September 23, 2013 (Response to CHIR No. 2).

Proposal One would implement a simpler method for calculating the Alaska Air Adjustment Factor within Cost Segment 14 (Purchased Transportation), rather than within the Cost and Revenue Analysis (CRA), using postal operational data from the Transportation Cost System (TRACS) instead of U.S. Department of Transportation data.

Proposal Two would establish a single set of distribution factors to assign relevant costs from the Non-Preferential Alaska Air, Preferential Alaska Air, Hawaii Air, and Air Taxi cost pools to products using current postal operational data from the TRACS. The proposal would also remedy an inaccuracy in the distribution of Air Taxi costs.

Proposal Three would create a set of proxy distribution factors, updated quarterly, to assign relevant costs from Cost Segment 14 Highway Plant Load and Rail Plant Load cost pools to products as an alternative to the current distribution factors, which are derived from special studies.

Proposal Four would revise the current methodology for calculating outbound air transportation costs to Canada by product such that total international transportation costs reported by product and country in the “Booked” version of the International Cost and Revenue Analysis (ICRA) Report would be brought into agreement with the “Imputed” version of the ICRA.

Proposal Five would change the current methodology based upon pounds for distributing settlement costs reported in the ICRA for Global Direct Outbound Admail to Negotiated Service Agreements (NSAs) in the Global Plus products. The new methodology would be based upon revenues.

The Commission approves Proposals One through Proposal Five. Each proposal is discussed below.

II. PROPOSAL ONE: NEW FORMULA FOR CALCULATING ALASKA AIR ADJUSTMENT FACTOR IN COST SEGMENT 14

A. Postal Service Proposal

The Postal Service proposes to alter the methodology for calculating the Alaska Air Adjustment Factor. Petition at 2-3. This factor is used to adjust attributable costs for Non-Preferential Intra-Alaska Air transportation to the attributable costs that would have been incurred if highway transportation were available. The residual is allocated to institutional costs.

The current methodology of computing the factor is complex and involves line haul, terminal handling costs, surface densities, and Department of Transportation data on bush and line haul transportation rates.⁹ *Id.* at 2. The current factor of 0.0702 was calculated in Docket No. R2005-1 and was based on FY 2004 data.¹⁰ The Postal Service notes that operational data have improved to the point where unit highway costs by contract type are available. With the improved data a new, simpler formula can be developed that provides a more accurate ratio of highway to air transportation costs. *Id.* The information is developed from the Transportation Cost System (TRACS), transportation account costs from the general ledger, and the Surface Air Management System – Alaska (SAMS–Alaska). *Id.* at 3. The Postal Service also claims that the new formula can be updated annually.

The proposal more than doubles the attribution level of Non-Preferential Alaska Air costs. This would increase the costs of the Alaska Bypass Service product by \$7.7 million. Non-Preferential Alaska Air costs allocated to other products increase by \$1.9 million. Total attributable costs for the component would be \$9.6 million higher than under the current calculation methodology. These impacts by product were confirmed by the Postal Service in response to CHIR No. 1, question 2. Additionally, CHIR No. 1 requested information on the derivation of the estimated cost for the Alaska

⁹ The current methodology is described in Docket No. R2005-1, USPS-LR-K-36.

¹⁰ Docket No. R2005-1, USPS-LR-K-36, Filename “Alaska Air Adjustment Factor FY 2004.XLS.”

Bypass Service product in relation to the total costs of Non-Preferential Alaska Air transportation. The Postal Service responded that the costs for the Alaska Bypass Service are tracked by SAMS–Alaska and are a subset of the general ledger accounts that make up the Non-Preferential Alaska Air cost pool.

The Postal Service is also proposing to move the calculation of the Alaska Air Adjustment Factor from the CRA model to the Cost Segment 14 workpapers. According to the Postal Service, this change will increase transparency and remedy a deficiency by matching the attributable costs for cost component 681 (Domestic Alaska Air Costs) as reported in the Cost Segment 14 workpapers and the costs as reported in the “C” report of the CRA. Petition at 3.

B. Participant Comments

The Public Representative notes that under the current methodology the cost coverage for the Alaska Bypass Service is “healthy” and that the doubling of the attributable costs under the proposed methodology should have no impact on the price of the Alaska Bypass product. PR Comments at 3. The product would still provide a “healthy” cost coverage margin. *Id.*

C. Commission Analysis

Proposal One simplifies the calculation of the Alaska Air Adjustment factor significantly from the current methodology. The current methodology requires a special study and is not amenable to annual updates using the most recently available transportation data. Additionally, the Department of Transportation data are not Postal Service-specific. The new SAMS–Alaska data collection subsystem compiles information on every air transportation contract utilized within Alaska, which can be used to update the Alaska Air Adjustment factor annually with data specific to the actual cost incurred by the Postal Service. This improvement in the development of transportation data in Alaska should enable the Postal Service to more accurately determine the proper ratio of highway to air transportation. Moving the calculation from

the CRA model to the Cost Segment 14 workpapers is strictly mechanical. The factor has always been determined outside the CRA model, however the application of the factor was accomplished within the model. The application of the factor to unadjusted Domestic Alaska Air costs outside of the CRA model is easily accomplished. See Response to CHIR No. 1, question 1. For these reasons, the Commission approves this proposal.

III. PROPOSAL TWO: NEW SET OF DISTRIBUTION FACTORS FOR NON-PREFERENTIAL ALASKA AIR, PREFERENTIAL ALASKA AIR, HAWAII AIR AND AIR TAXI COST POOLS IN COST SEGMENT 14

A. Postal Service Proposal

The Postal Service proposes to develop a single set of distribution factors for Non-Preferential Alaska Air (for products other than Alaska Bypass), Preferential Alaska Air, Hawaii Air, and Air Taxi cost pools. Petition at 4-7. The current methodology is based on special studies dating to Docket No. R97-1. *Id.* at 6.

The proposed distribution factors rely on data derived from the SAMS–Alaska and data that have been continually collected by TRACS. While this information will provide accurate information for the Non-Preferential and Preferential Alaska Air costs, it will only serve as a proxy for Hawaii Air and Air Taxi costs. *Id.* at 4. Pounds flown on the Alaska network are split into three groups: Alaska Bypass, Air, and Surface. Separate distribution factors are determined for the air and surface portions using TRACS data. The air and surface distribution factors are derived by product using product shares across all TRACS modes, pounds for air and cubic-feet for surface transportation. These distribution factors are then used to calculate the proposed distribution to products by weighting the air pounds and the cubic-foot miles by the total air and surface pounds. *Id.* at 4-5.

The Postal Service also notes that the proposed new distributions would solve an apparent inaccuracy for Air Taxi costs. The current methodology for Air Taxi costs uses a distribution key that aggregates weighted costs from other air cost pools. Because

FedEx Day costs, which are distributed on the basis of cubic-feet, constitutes the bulk of these weighted costs, the distribution key is heavily weighted toward cubic-feet. Since pounds are the primary cost driver for Air Taxi costs, a distribution key using pounds as the primary distribution key is more appropriate. *Id.* at 6.

B. Participant Comments

The Public Representative claims that he was unable to determine the impact of the implementation of Proposal Two. PR Comments at 4. He notes that a table comparing the cost effects of the proposal was not provided, nor was the total attributable cost for FY 2012 for the transportation cost pools that would be affected provided in the Postal Service's proposal. *Id.* However, he was able to review the percent distributions both before and after the proposal. He says that the changes in the distribution key as proposed by the Postal Service could increase attributable costs for Periodicals and Media/Library mail, which already have cost coverages below 100 percent. *Id.* at 5-6. The Public Representative also says that the proposal to change the cost driver for Air Taxi costs from cubic-feet to pounds may be inconsistent with how costs are incurred, which should reflect the purpose for the use of Air Taxi service. *Id.* at 6.

C. Postal Service Reply Comments

The Postal Service responds to the Public Representative comments by stating that the proposal contains all the information needed to perform the type of comparison analysis the Public Representative says he was unable to do. Reply Comments at 1. Additionally, the Postal Service included a table that sets forth the aggregate impact of the proposal on each product's attributable costs. *Id.* at 1-2. The Postal Service reiterates that the current methodology used to distribute costs to products in the Non-Preferential and Preferential Alaska Air and Hawaii Air are outdated, or in the case of Air Taxi, theoretically flawed. *Id.* at 2-3. The Postal Service also notes that whether the proposal increases or decreases costs assigned to products is not germane. It argues

that the main question the Commission is required to answer is whether the proposal results in a more accurate method of estimating costs by product. Whether the proposed change results in lower or higher product costs is irrelevant. *Id.* at 3.

D. Commission Analysis

The current cost distributions for Alaska Air and Hawaii Air are based on proxy distribution keys adjusted on the basis of a special study produced in 1997. Since the special study data were based on the pre-PAEA product list, the Postal Service includes another adjustment to reflect the current product list in the distribution key. The proposed distributions have advantages over the current procedure. First, the data used to develop the distributions are current as to the product list. No adjustments to the pre-PAEA classes, subclasses, and rate categories would be needed. Additionally, for both Preferential and Non-Preferential Alaska Air the actual highway and air contract information from the SAMS–Alaska data subsystem provides a more accurate representation of the Alaskan transportation costs because it reflects costs by product. While comparable data for Hawaii Air and Air Taxi are not yet available, the Commission is satisfied that the SAMS–Alaska information will serve as a more suitable proxy. However, if feasible, an effort should be made to find more reliable data for Hawaii Air and Air Taxi distributions to products. Also, revising the distribution key for Air Taxi costs to reflect how costs are actually incurred improves the accuracy of reported product costs. For these reasons, the Commission approves Proposal Two.

The Public Representative contends that the Postal Service failed to provide sufficient information to determine the impact of the proposed distribution keys. PR Comments at 4, 6. In response, the Postal Service asserts that the proposal “contains all of the information necessary to perform such an analysis.” Reply Comments at 1. It states that the current and proposed attributable costs by product can be calculated from the table included in its Petition. It also submits an additional table showing the aggregate impact of Proposal Two on each product’s attributable costs. *Id.* at 1-2.

The Postal Service's response provides helpful clarification. To facilitate analysis of future filings of this nature, the Postal Service must provide not just distribution percentages, but the actual change in costs by product resulting from the proposed methodological change, similar to what the Postal Service provided in its Reply Comments.

IV. PROPOSAL THREE: NEW SET OF PROXY DISTRIBUTION FACTORS FOR HIGHWAY AND PLANT LOAD COST POOLS IN COST SEGMENT 14

A. Postal Service Proposal

Highway and rail plant load cost distribution factors are currently based on special studies last developed in Docket No. R2005-1. The Postal Service is proposing to develop a proxy set of product distribution factors that are relevant to plant load costs. Petition at 8-10. Plant load contracts are used to transport mail from a mailer facility bypassing one or more postal facilities. This mail would otherwise be introduced into a network distribution center (NDC) facility for processing, thereby making the use of an Inter-NDC proxy distribution reasonable and rational. *Id.* at 9. The Postal Service also notes that the costs of plant load contracts have decreased significantly. Updating the special studies would be expensive and the use of a proxy distribution key that can be updated quarterly is a more sensible method. *Id.* at 8.

As with Proposals One and Two, the Postal Service has provided a comparison of the percent distribution of costs to products rather than showing the changes in product costs due to the proposal. *Id.* at 9.

B. Participant Comments

The Public Representative asserts there is insufficient information in the proposal to estimate the impact of the changes on product costs. PR Comments at 6. Therefore, he does not render an opinion on the efficacy of the proposal.

C. Postal Service Reply Comments

The Postal Service asserts that the impacts of the proposal can be calculated with the information provided in its Petition. Reply Comments at 4. The Postal Service notes that the Commission was able to develop a comparison table of cost impact for Proposal Three in its Response to CHIR No. 1, question 4. *Id.*

The Postal Service reiterates its contention that the Proposal provides an updatable distribution key for plant load costs where the current methodology cannot be updated with new information nor readily updated for changes in the product lists. *Id.*

D. Commission Analysis

As with Proposal Two, Proposal Three alters the current methodology of relying on outdated special studies by substituting updatable proxy distributions to develop costs by product. The Postal Service notes that plant load contracts are generally used instead of Inter-NDC contract transportation to provide transportation from a mailer's facility bypassing one or more other postal facilities. Without plant load type contracts the mail on this network would be entered into the postal system at an NDC. The use of an Inter-NDC proxy appears to be appropriate based on the plant load because it is consistent with the definition provided in the Postal Service's proposal and it limits the cost distribution to the products that utilize plant load transportation contracts. As the Commission stated in its analysis of Proposal Two, the Postal Service should present not just distribution percentages, but the actual change in costs by products that results from the change in methodology so that parties can readily see the impacts of the proposed changes.

The Commission agrees with the Postal Service on the advantages regarding the proposed change in plant load cost distributions and approves Proposal Three.

V. PROPOSAL FOUR: CHANGE IN METHODOLOGY FOR OUTBOUND AIR TRANSPORTATION COSTS TO CANADA

A. Postal Service Proposal

The Postal Service proposes to change the current methodology of developing air transportation costs for outbound international products to Canada and all other countries presented in both the “Booked” and “Imputed” versions of the ICRA. Petition at 11-22.

1. Current Methodology

International (and domestic) transportation costs by mode are reported in Cost Segment 14 (Purchased Transportation).¹¹ Air transportation costs for outbound international products, other than Surface Airlift, are reported in the Cost Segment 14 International Air Transportation Account 53201, while surface transportation costs for outbound products are reported in the Cost Segment 14 International Surface Transportation Account 53281.¹² Total international transportation costs for outbound products reported in both the Booked and Imputed versions of the FY 2012 ICRA are reconciled to the costs reported in the Cost Segment 14 (Purchased Transportation) accounts—the audited costs for transportation services purchased by the Postal Service.

¹¹ See Library Reference USPS-FY12-32, FY 2012 CRA “B” Workpapers (Public Version), Excel file CS14.xls; see also Library Reference USPS-FY12-NP29, Fiscal Year 2012 Cost Segments and Components Reconciliation to Financial Statements and Account Reallocations (Non-Public Version), Excel file RealTB-FY12-NP29.xls. In addition, Cost Segment 14 in its entirety is replicated in the ICRA. See Library Reference USPS-FY12-NP2 (revised 2-8-13), Excel file cs14.fy12.nonpublic.dec06.xls (under seal).

¹² A negligible amount of international water-borne transportation costs for outbound products are reported in Cost Segment 14. For analysis purposes, this amount is subsumed with the Cost Segment 14 International Surface Transportation Account and will not be discussed further.

Imputed costs. The Postal Service separately develops international air transportation costs for outbound mail products using the Imputed methodology.¹³ International air transportation costs for each outbound product for Canada and all other countries are developed from postal operations and accounting data on weight (in kilograms) and air transportation billings.¹⁴ Using a cost adjustment factor, total international air transportation costs for all outbound products are adjusted to match the “control total” cost reported in the Cost Segment 14 International Air Transportation Account.¹⁵

Postal operations data also provide weights for various broad categories of mail destined to Canada that are dispatched by truck rather than air transportation. *Id.* at 15. In a separate calculation, these data are used to “impute” the costs of outbound Canada air mail products diverted to highway transportation.¹⁶ The resulting costs for outbound Canada air mail diverted to highway transportation are added to the adjusted international air transportation costs for Canada and all other countries and reported in the Imputed version of the FY 2012 ICRA. *Id.* at 18.

Booked costs. The Postal Service develops international air transportation costs by product reported in the Booked version of the FY 2012 ICRA using a different methodology. First, international air transportation costs for Canada and all other

¹³ More specifically, international transportation costs are developed for specific outbound “ICRA product categories.” Petition at 15. In the ICRA, these product categories are ultimately combined into the products shown in the market dominant and competitive product lists, and reported in the Booked and Imputed versions of the ICRA. The Commission herein uses the general term “product(s)” to refer to the ICRA product category(ies).

¹⁴ For a technical description of the development of international transportation costs by product and country, see Library Reference USPS-FY12-NP5, “International Cost and Revenue Analysis, Summary Description and Documentation,” Volume I, Part 2, “Technical Description,” Chapter 4, “Development of International Transportation Costs,” Docket No. ACR2012.

¹⁵ The Postal Service uses the term “benchmark” to refer to the transportation costs reported in the Cost Segment 14 International Air and Surface Transportation Accounts, and “benchmarking” to refer to the process of adjusting total international air and water transportation costs as a whole to the costs reported in such accounts.

¹⁶ As used herein, the term “air mail” refers to any outbound product transported to foreign destinations via international air carriers.

countries are developed using the Imputed methodology, *assuming* the outbound products to Canada are transported entirely by air. The resulting imputed international air transportation costs for Canada and all other countries are then adjusted to match the control total costs reported in both the Cost Segment 14 International Air Transportation account *and* the Cost Segment 14 International Surface Transportation Account. Response to CHIR No. 2, question 2(a). Unlike the Imputed methodology, however, the costs of outbound Canada air mail products diverted to highway transportation are not separately calculated or reported in the Booked version of the ICRA. Petition at 19. Therefore, total international transportation costs reported in the Imputed version of the FY 2012 ICRA exceed the Booked version. *Id.* at 21.

Origin of proposal. In May 2007, the Postal Service stopped offering outbound international products transported via surface modes, virtually eliminating costs reported in the Cost Segment 14 International Surface Transportation Account. Petition at 12. Consequently, beginning with FY 2008, the Postal Service stopped developing international surface transportation costs for each outbound product by country. Nevertheless, a relatively small amount of residual surface transportation costs continued to be reported in the Cost Segment 14 International Surface Transportation Account from FY 2008 through FY 2012. *Id.*

More recently, the Postal Service observed that the residual costs reported in the Cost Segment 14 International Surface Transportation Account were approximately equal to the calculated total cost of outbound Canada air mail diverted to highway transportation.¹⁷ This prompted the realization that diverted highway transportation costs, once obscured by the much larger international surface transportation costs reported for outbound mail, “have become discernible with elimination of Outbound Surface Mail Products.” *Id.* at 12-13. The Postal Service therefore decided to use this information to enhance the ICRA. *Id.* at 13.

¹⁷ *Id.* at 12; see also Response to CHIR No. 1, question 5.

2. Proposal Four

Proposal Four consists of two revisions.¹⁸ The first revision changes the Imputed methodology of adjusting total international air transportation costs for outbound products to the cost reported in Cost Segment 14 International Air Transportation Account. The sum of imputed air transportation costs to Canada *and* the cost of outbound Canada air mail diverted to highway transportation, plus air transportation costs for all other countries, would be adjusted to the combined control total costs reported in Cost Segment 14 International Air Transportation and International Surface Transportation Accounts. *Id.* at 11. The Postal Service maintains that with this change, the “benchmarking [process] can be enhanced by bringing the Imputed Air and Truck [Surface] Transportation costs into alignment with the total [costs reported in the] CS 14 Purchased International Transportation Accounts that include both Air and Surface Transportation.” Response to CHIR No. 2, question 1.

Under the second revision, the adjusted international transportation costs developed as described in the first revision (above) would be reported in the Booked version of the ICRA. Petition at 11. This means that the international transportation costs reported in both the Booked and Imputed versions of the ICRA would be identical. Response to CHIR No. 2, question 2(a).

The Postal Service states that this change preserves the separately calculated costs of outbound Canada air mail diverted to highway transportation by product. Petition at 20. In addition, this change removes an undesirable outcome that the Postal Service “believe[s] to be merely an artifact of the current Booking methodology,” *i.e.*, the relatively larger share of international air transportation costs reported for Canada in the

¹⁸ Library Reference USPS-LR-RM2013-6/NP1, which accompanies the Petition, consists of two Excel files. Attachment 1.xls shows the development of the proposed methodology. Attachment 2.xls compares the Imputed version of the ICRA based upon the proposed methodology to the Imputed version of the ICRA reported by the Postal Service in the FY 2012 Annual Compliance Report (ACR). Attachment 2.xls also compares the Booked version under the proposed methodology to the Booked version of FY 2012 ICRA reported in the ACR.

Booked version compared to the Imputed version of the FY 2012 ICRA.¹⁹ The Postal Service states that this outcome results from reporting the more costly international air transportation costs for outbound products to Canada without removing the costs for outbound Canada air mail products diverted to highway transportation. *Id.* at 20.

In addition, Proposal Four corrects a small error in the development of total volume variable costs for international mail presented in the Booked version of the FY 2012 ICRA. The Postal Service explains that certain international transportation costs from the Imputed version of the ICRA were inadvertently used in developing the Booked version of the FY 2012 ICRA. Response to CHIR No. 2, question 2(b). As a result, total volume variable costs for international mail in the Booked version of the ICRA under the proposed methodology are less than in the Booked version of the FY 2012 ICRA. *Id.* Under the proposed methodology, these costs are not used in developing the Booked version of the ICRA.

B. Participant Comments

The Public Representative recommends Commission approval of Proposal Four. PR Comments at 7. However, he suggests the need for additional information to clarify the development and application of this change in methodology. *Id.* In this regard, the Public Representative states that “the total Volume Variable Cost for Market Dominant and Competitive Products, in both the Booked and Imputed pages, differs between the ACR method and the Proposed Method,” citing the Excel file Attachment 2.xls. *Id.* at 8. The Public Representative suggests that the Postal Service explain this difference. *Id.*

The Public Representative also notes that certain cells in the Excel files are comprised of hardcoded numbers, and therefore the source of the data “could not be readily ascertained.” *Id.* at 7. In addition, the Public Representative notes that certain calculations that rely on the “ICM Costing Module should be linked to the source data or

¹⁹ *Id.*; see also *id.* at 11, where the Postal Service refers to this outcome as “the shift in costs between Canada and the rest of the world.”

otherwise explained.” *Id.* Finally, the Public Representative urges the Postal Service to make public in this docket aggregate cost data that is already public in other dockets. *Id.* at 8.

C. Commission Analysis

Proposal Four is a complicated change in methodology that achieves several worthwhile goals. It preserves the separate calculation of the imputed cost of outbound Canada air mail products diverted to highway transportation, which properly reflects the existence of diverted highway transportation costs, for use in both the Booked and Imputed versions of the ICRA. In addition, the change in methodology eliminates the shift in international air transportation costs to Canada from all other countries that now occurs in developing the Booked version of the ICRA. Finally, international transportation costs reported in both the Booked and Imputed versions of the ICRA would be identical, and match the combined control total costs reported in the Cost Segment 14 International Air and International Surface Transportation Accounts.

As the Public Representative observes, there are unexplained differences in the total volume variable costs for market dominant and competitive products in the Booked and Imputed versions of the ICRA under both the proposed methodology and as reported in the ACR. In response to an information request, the Postal Service provides a table showing the changes in volume variable costs (and contribution) for market dominant and competitive international mail between the Booked (and Imputed) versions under the proposed methodology and the Booked version of the FY 2012 ICRA.²⁰ The most significant of these changes is the shift in volume variable costs from market dominant to competitive international mail that results from the proposed methodology.

The Postal Service explains that in developing the Booked version of the FY 2012 ICRA, there is a shift in total volume variable costs *from* Competitive Products *to*

²⁰ Response to CHIR No. 2, question 2.

Market Dominant Products in comparison to the Imputed version of the FY 2012 ICRA. Response to CHIR No. 2, question 2(a) (emphasis added). The shift arises because there are proportionately more market dominant than competitive international air transportation costs used in developing the Booked version of the FY 2012 ICRA. *Id.* Under the proposed methodology, this “shift does not occur . . . [resulting] in a lesser amount of Market Dominant International Transportation cost in the Booked version under Proposal Four relative to the Booked version of the FY 2012 ICRA and a greater amount of Competitive Product International Transportation cost.” *Id.* The Commission concludes that eliminating this shift results in a more accurate development of international transportation costs by product.

The Commission also accepts the proposed correction of the inadvertent error.

The Public Representative also observes the existence of hardcoded data in a number of cells that were not sourced and calculations that were not linked to source data or otherwise explained. When the Postal Service files electronic spreadsheets, the reporting rules require it to provide sources for data used in calculations, display the formulas used and links to related spreadsheets. See 39 C.F.R §§ 3050.2(b) and (c). Following the rule enables the Commission and the public to replicate the figures in spreadsheets.

The Commission approves Proposal Four, which represents an improvement in developing air transportation costs for outbound international products to Canada and all other countries presented in both the Booked and Imputed versions of the ICRA.

VI. PROPOSAL FIVE: CHANGE IN METHODOLOGY FOR DISTRIBUTING SETTLEMENT COSTS FOR CERTAIN INTERNATIONAL NEGOTIATED SERVICE AGREEMENTS

A. Postal Service Proposal

The Postal Service proposes to change the current methodology based upon pounds for distributing Global Direct Entry Outbound (GDEO) Admail settlement costs

to NSAs in the Global Plus products reported in the ICRA.²¹ The current methodology produces a distribution factor that is a uniform average rate per pound: total settlement payments / total Admail pounds * NSA Admail pounds.²² The Postal Service proposes replacing this factor with one based on total revenue, or “revenue shares” (total settlement payments / total Admail revenue * NSA Admail revenue). Revised Response No. 3 at 3.

Background. In the FY 2012 ACD, the Commission expressed a concern that the Global Plus 2B and 2C products, which consist of volume-based prices offered through NSAs for Global Direct Outbound Admail (letterpost) to Canada, failed to generate sufficient revenues to cover attributable costs. The Commission observed that this financial result was attributable to two NSAs with the same commercial mailer. FY 2012 ACR at 169-70. The Commission therefore directed the Postal Service to report on whether a third NSA with the same commercial mailer in the Global Plus 2C product complies with 39 U.S.C. § 3633(a)(2). *Id.* The Commission also directed the Postal Service to modify the financial model for Global Plus NSAs to more accurately develop costs and to report on such modifications, and any other modifications, likely to affect compliance with section 3633(a)(2). *Id.*

Postal Service explanation. The Postal Service states that in FY 2012, Outbound (U.S. origin) Admail as a whole generated more revenue than its settlement costs plus estimated domestic handling and transportation costs. Revised Response No. 3 at 3. It also identifies settlement costs, which consist of Postal Service payments based upon Canada Post rates for the delivery of Outbound Admail in Canada, as “by far the most significant” *Id.*

The Postal Service maintains that revenues exceeded settlement costs because the negotiated prices the Postal Service charged commercial mailers for Outbound Admail were greater than the Canada Post Admail rates charged the Postal Service. *Id.*

²¹ Proposal Five is described in the Postal Service's Revised Response No. 3 to the FY 2012 ACD report. See notes 3-5, *supra*.

²² The Postal Service variously calls this factor a “pound rate” or “pound share.”

at 5. The Postal Service therefore concludes that if the product as a whole provides positive contribution, so should the individual contracts. *Id.* at 4. Nevertheless, under the current methodology of distributing settlement costs, two NSAs with the same commercial mailer reported costs exceeding revenues. *Id.* at 3.

For FY 2012, the Postal Service suggests that the two NSAs may have performed better than estimated. *Id.* at 4. The reason offered by the Postal Service is that the actual Canada Post rates for Admail are more complicated than the uniform average pound rate used to distribute such costs. *Id.* The Postal Service also notes that the two NSAs each had a total mail weight that was higher than any of the other NSAs. *Id.* The distribution of settlement costs to NSAs based upon a uniform average pound rate therefore assigns more costs to the two NSAs. By contrast, if the proposed methodology had been in place in FY 2012, all of the contracts would have shown positive contribution. *Id.*

CHIR No. 1, question 9 queried the Postal Service about the possibility of using information from mailer manifests, which provide shape, weight per piece, and sortation-level data for all shipments of Outbound Admail, to distribute settlement costs directly to NSAs. The Postal Service responded that shipment-level detail from mailer manifests is not needed for the proposal as the use of revenue shares yields much better approximations of settlement cost estimates for NSAs in each product than pounds. Response to CHIR No. 1, question 9. Moreover, it states that mailing manifests are not readily available electronically and claims that even if available, their use “would add little additional precision to the proposal’s settlement estimates” for each NSA. *Id.*

Under these circumstances, the Postal Service states that in the absence of useable NSA-specific shipment-level detail that could otherwise be used to directly determine settlement costs, distributing settlement costs to the NSAs based upon revenue share rather than pounds is more appropriate. *Id.* at 3, 5. Moreover, because Canada Post provides the Postal Service with the amount of settlement costs for Global Direct Outbound Admail as a whole, the use of revenue shares will provide the most accurate estimate of settlement payments for each NSA. *Id.* at 3.

B. Participant Comments

The Public Representative states that the distribution of settlement costs using revenue shares instead of pound shares “is an improvement, as revenue is a better reflection of the cost causing characteristics of the product than pound shares.” PR Comments at 9. However, the Public Representative maintains that the distribution of settlement costs can be improved further with the usage of shipment-level detail. *Id.*

C. Commission Analysis

Under the proposed methodology, settlement costs for Global Direct Entry Outbound Admail to Canada will be distributed based upon revenue “shares.” Given the absence of readily available electronic mailer manifests, the use of revenue shares represents a better proxy for the distribution of settlement costs than pounds because revenue better reflects how settlement costs are incurred. This follows from the fact that settlement costs are by far the most significant category of cost. Moreover, the Postal Service’s schedule of prices for Outbound Admail mirrors Canada Post’s schedule of rates for the delivery of Admail. The Postal Service’s prices exceed Canada Post’s rates, which are used to calculate the Postal Service’s settlement costs. As a result, Proposal Five will improve the estimate of costs for each NSA within the Global Plus products.

The Public Representative states that requiring the use of shipment-level details from mailer manifests would more accurately estimate the settlement costs for each NSA. However, the Postal Service states that using such details would first require it to collect and assemble mailer manifests that are not readily available electronically. Response to CHIR No. 1, question 9. Moreover, it also contends that the additional precision gained is likely to be small. *Id.* While use of shipment-level details may be desirable, such details are currently not available. Should electronic mailer manifests become readily available, the Postal Service should consider revising the methodology accordingly.

The Commission approves Proposal Five's methodology for distributing settlement costs.

It is ordered:

For purposes of periodic reporting to the Commission, the Commission accepts the changes in analytical principles proposed by the Postal Service in Proposal One through Proposal Five in Docket No. RM2013-6 as set forth in the body of this Order.

By the Commission.

Shoshana M. Grove
Secretary